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U.S. ECONOMIC POLICY IN GERMANY

J. Herbert Furth

The Joint Chiefs of Staff, after approval by the War, State, and Navy Departments, sent to the Military Governor in Germany a new directive dated July 11, 1947, which supersedes the famous directive to General Eisenhower, "JCS 1067" of April 26, 1945.

The new directive enumerates three economic objectives of the U.S. Government in Germany, namely, to eliminate war industries, to exact reparations, and "to encourage the German people to rebuild a self-supporting state devoted to peaceful purposes, integrated into the economy of Europe." This third objective distinguishes the new directive from the old one which aimed, apart from disarmament and reparations, merely at "the production and maintenance of goods and services required to prevent starvation or such disease and unrest as would endanger /the occupation/ forces." The Military Governor also is directed to assist the German people "in the development of a balanced foreign trade," while General Eisenhower was instructed to "take no steps looking toward the economic rehabilitation of Germany or designed to maintain or strengthen the German economy." These differences indicate the shift from a wartime policy to one aimed at peaceful reconstruction.

Economic Disarmament

The first objective is "to eliminate industry used solely to manufacture and to reduce industry used chiefly to support the production of arms, ammunition, and implements of war." This program appears to be less comprehensive than the original plan of complete and permanent industrial disarmament. If the directive were taken literally, no restriction would be applied to those industries that do not chiefly support war production. This would mean that only outright armament plants would remain controlled, while there would be no limitation on the development of steel, machinery, chemical, and transportation industries, which after all even in prewar Germany were chiefly engaged in producing civilian rather than military goods. The directive, however, need not be interpreted in this manner since the very next paragraph expresses the desire of the U.S. Government to fulfill "the principles of the Potsdam Agreement regarding ... industrial disarmament." Thus the word "chiefly" must be taken to include all industries that can be considered parts of Germany's war potential. So interpreted, the directive would not constitute any substantial departure from the principles hitherto applied.

Reparations

The directive limits reparations from Germany to those "provided by the Potsdam Agreement." It also reiterates the opposition of the U.S. Government to any kind of reparations that would impose financial burdens upon the United States or postpone "the achievement of a self-sustaining German economy." These statements apparently exclude all reparations from current output and confine them to the removal of excess industrial capital equipment and the surrender of German external assets.

Reconstruction of German Economy

Economic unity. The directive emphasizes the wish of the U.S. Government to implement the provision of the Potsdam Agreement that Germany be treated as an economic unit. It instructs the Military Governor, however, to proceed unilaterally on most of the important questions "pending agreement in the Control Council," and in general to "exert every effort to achieve economic unity with other zones."

Level of industry and standards of living. The Potsdam Agreement is interpreted in the directive in the sense that the level of industry--be it the level fixed by the Allied Control Council on March 28, 1946,1/ or another level to be established by some or all of the Zone Commanders--should only determine excess industrial capacity for the purpose of reparation removals, but should not permanently restrain German industrial activity. The German people, after the period of reparation removals, "should not be denied the right ... to develop their resources for the purpose of achieving higher standards of living." Under the Potsdam Agreement, the reparation removals were to be completed within two and one-half years from the time of the Berlin Conference. If this schedule were still considered valid, all restrictions upon the level of industry, except for war industries, and upon the standard of living of the German people would

1/ See this Review, January 28, 1947, supplement, p. 7.

be removed as of February 2, 1948. It is fairly certain, however, that this date will be postponed in view of the lag in the implementation of the reparation program. The directive states that the economic program for Germany "should be directed toward an increasing standard of living in Germany." No time limit is mentioned in this connection. This provision may be compared with the directive of 1945, under which the level of basic living conditions in Germany was limited to "that existing in any one of the neighboring United Nations," and to the provision of the Potsdam Agreement that "average living standards" in Germany should not exceed those of "all European countries, excluding the United Kingdom and the U.S.S.R."

Industrial and agricultural production. Despite a widespread belief to the contrary, neither the directive of April 1945 nor the Potsdam Agreement provided for the de-industrialization of postwar Germany. The Potsdam Agreement stated only that "primary emphasis be given to the development of agriculture and peaceful domestic industry." The new directive desires the adoption of a program that "should give highest priority to increased production of coal, food, and export goods." The emphasis has shifted only insofar as the importance of foreign trade for the recovery of Germany as well as of the rest of Europe is recognized by accentuating export goods rather than domestic industries. Efforts toward maximizing agricultural production are to continue; recent plans of Military Government provide for substantial imports of fertilizer and seed in order to reduce the extremely burdensome importation of foodstuffs into the combined U.S. and U.K. zones.

Foreign trade. The principle is stated that all goods and services exported from Germany (other than reparations and restitutions) should be fully paid for either "in approved imports or in foreign exchange which can be utilized for the payment of approved imports." This statement obviously is directed against the practices of the Soviet (and the French) occupation authorities which do not pay for all commercial exports of their zones in goods or free foreign exchange.1/

The directive also provides for the pooling of all export proceeds "first to meet the import needs of Germany ... and secondly to compensate the occupying powers for past expenditures ... priority in the latter case being given to payment of costs sustained for essential imports." This provision, which is consistent with both the bizonal agreement of December 2, 1946, and the Potsdam Agreement, makes it clear that German export receipts not needed for the payment of current imports shall be used first of all for the repayment of the sums advanced by the United States and the United Kingdom for "Category A" imports2/ rather than for occupation costs or reparations.

The directive urges the Military Governor to work for "the restoration of normal international commercial relations between Germany and the rest of Europe." In the first place, Germany shall export "goods needed by European countries for their economic recovery and rehabilitation insofar as these countries may provide in payment needed imports for Germany or free foreign exchange which can pay for such imports." Even if Germany's trading partners, however, are unable to pay for German exports in full, commercial relations should be resumed, if necessary with the aid of increased U.S. expenditures in Germany or financial assistance to Germany's

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1/ See this Review, May 6, 1947, p. 21.
2/ See this Review, January 28, 1947, supplement, p. 11.

trading partners. This provision will enable Military Government to compensate the Netherlands and Belgium for the use of their ports and thus end the exclusive use of German ports for the overseas trade of Western Germany. It will also make it possible to aid countries that are unable to pay in free foreign exchange for vital imports (coal) from Germany or for German transit charges. Substantial transactions of that kind "should be referred to the U.S. Government for decision."1/ The Military Governor is directed to "consult other European countries and international organizations ... in matters of German production and trade," making possible the integration of German reconstruction into any plan for European recovery. Excessive burdens upon the U.S. Treasury are to be avoided by the prevention of all "non-essential imports" into Germany. The end of the activities of U.S. Government corporations in Germany's foreign trade is foreshadowed by a provision that foreign trade should be returned to "normal trade channels."

Finance. The Military Governor is directed to press for the adoption by the Allied Control Council of a program for financial reform. This program shall provide for a reduction in currency circulation as well as in public and private debts, for the "equitable sharing of the costs of war and defeat," and for "adjustments in the wage-price structure necessary for the restoration of balance between the financial structure and economic realities."2/ The directive is silent about the way in which such an adjustment should be accomplished. Efforts to have a similar program adopted by the Allied Control Council have been deadlocked for almost a year because of differences of opinion between the U.S. and the U.S.S.R. representatives as to the place where new currency shall be printed. The directive does not instruct the Military Governor to act unilaterally in case no quadripartite solution is to be found.

The Military Governor is directed to maintain accounts and records reflecting "the financial operations of OMGUS" and to calculate occupation costs, distinguishing between the so-called internal costs "supported by the Germany economy" itself, and the external costs temporarily financed by the occupying powers and eventually to be settled with Germany. When Military Government takes these measures, it will finally be possible to get a clear picture of the international balance of payments of the U.S. zone of Germany.

The Military Governor is also directed to "limit any foreign investment" in the U.S. zone. This provision may foreshadow a relaxation of the present policy of completely forbidding such investments.

All in all, the directive indicates that U.S. economic policy in Germany will conform to the renewed realization of Germany's key position in Europe's economy and to the recent efforts toward a general cooperation of all European countries for reconstruction and development.

1/ The wording of the pertinent section (18c) of the directive is somewhat misleading. It leaves room for the interpretation that increased American expenditures in Germany or aid to Germany's trading partners would be mandatory if needed for the restoration of normal commercial relations, and that only very rare cases should be referred to the U.S. Government for decision. The interpretation given in the text reflects the original intention of the drafters of the directive.

2/ See this Review, January 14, 1947, p. 15.

MONTHLY BALANCE OF PAYMENTS: SWEDEN AND DENMARK

Robert W. Bean

Much would be gained if balance of payments estimates could be made available on a current monthly basis, rather than only on the customary annual basis. This is ordinarily precluded by the difficulty of compiling reliable data quickly. Quite reliable monthly figures are often available, however, for two important items in the balance of payments: merchandise trade, and transfers of gold and foreign exchange. Comparison of these two sets of data affords some insight into the other items of the monthly balance of payments. This can be done effectively by plotting the foreign trade balance, cumulative month-by-month, alongside a curve showing net gold and foreign exchange holdings, as in the accompanying chart which shows these items for Sweden and Denmark from June 1945 to the most recent date available.

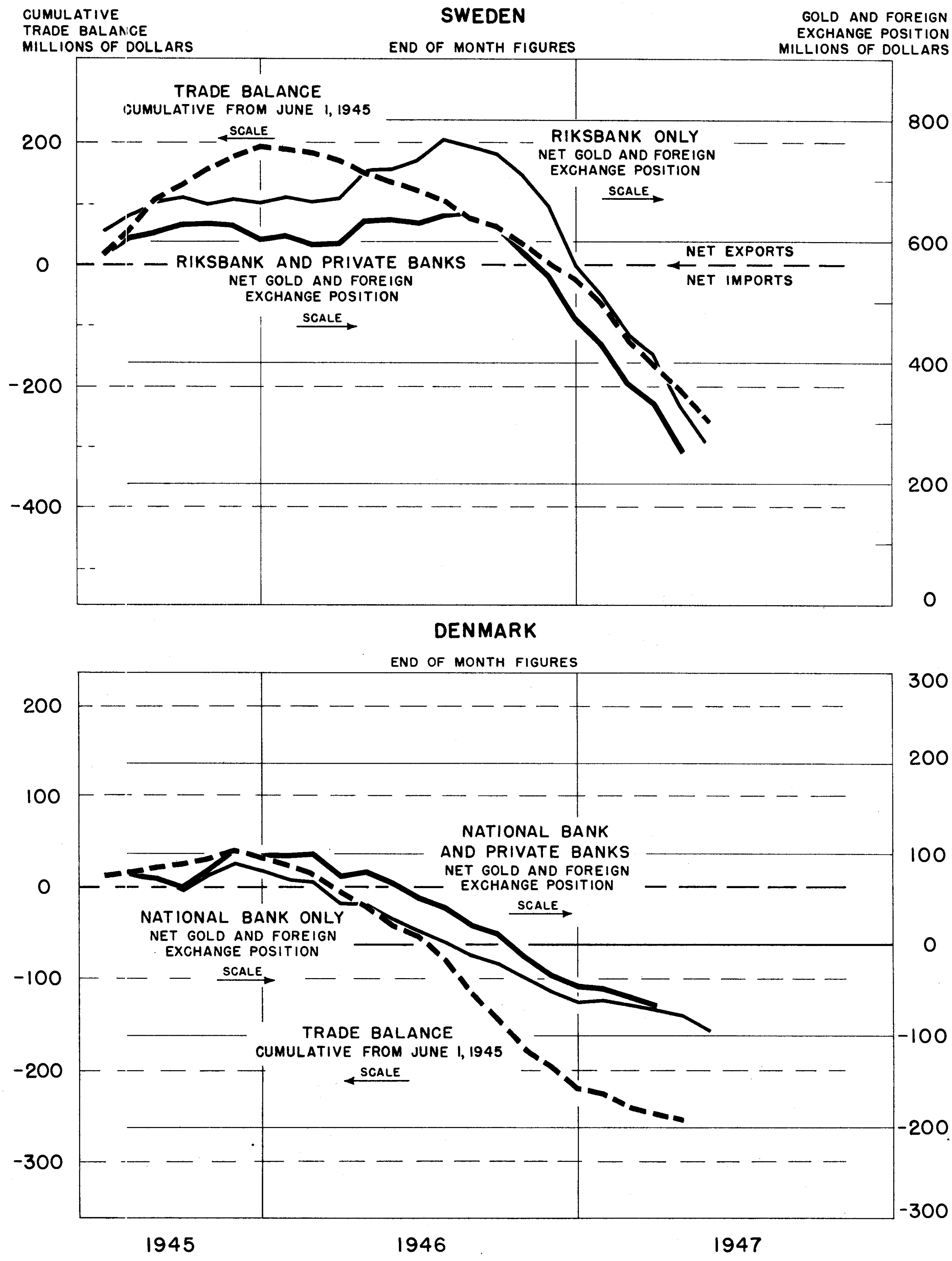
In the case of Sweden, attention is focused by the chart on three periods: from June to December 1945, from January to July 1946, and from July 1946 forward. By the end of 1945, Sweden had developed an export surplus of $195 million, yet during this first period shown on the chart net gold and foreign exchange holdings increased by only $20 million, reflecting the substantial credits made available to other countries. During the second period, Sweden experienced a surplus of imports, but until the appreciation of the krona in July 1946 the Riksbank's gold and foreign exchange holdings mounted rather than diminished.1/ Since July 1946, gold and foreign exchange have declined at a rate far exceeding the growth of the import surplus. This divergence is explained primarily by the speculative movement of funds in connection with the revaluation of the krona, a movement made more apparent by the changing position of the private banks. At the end of 1945, net liabilities of the private banks amounted to about $60 million. By the end of July 1946, however, they had permitted their net liabilities to reach almost $130 million, indicating that during the period before appreciation foreign exchange receipts were sold to the Riksbank and foreign exchange payments were postponed. After appreciation the practice was reversed, and by April 1947 the private banks' net foreign exchange liabilities had been reduced to $73 million.

These two factors--the extension of credit to other countries and the speculative movement connected with appreciation of the krona--have been the most important invisible items in the Swedish balance of payments. Addition of net shipping revenues and other current receipts to the trade balance curve on the chart would have the effect of emphasizing the foreign credits extended in 1945 and the capital outflow after July 1946.

As indicated by the chart, from the beginning of June 1945 to the end of April 1947 Denmark accumulated a total import surplus of more than $250 million. During this period, the country's gold and foreign exchange position deteriorated by less than $160 million. Net shipping receipts, however, probably more than accounted for the difference of $90 million (it is anticipated that they will amount to over $70 million in 1947), and in addition Denmark drew on a number of foreign credits during this period, so it is evident that the total of all other items represented net payments.

1/ The sharp rise in gold and foreign exchange holdings shown on the chart for the month of April 1946 is misleading, however, being due principally to a change in the Riksbank's method of accounting.

FOREIGN TRADE BALANCE AND NET GOLD AND FOREIGN EXCHANGE POSITION



Probably the most important of these was interest and amortization, which for the full year 1947 is estimated at more than $25 million. It is also possible that a significant amount of foreign exchange earnings has been left abroad, rather than offered to the Danish banks.

The usefulness of the chart is limited by lack of precision in the concept of foreign exchange. The line between what may be classified as foreign exchange and what should be classified as long-term credit is sometimes difficult to draw, and central banks do not follow uniform policies in this regard. Thus, the Swedish Riksbank normally carries credit balances accumulated under payments agreements among its foreign exchange assets, but from time to time certain amounts of these balances are transferred from the Riksbank to the National Debt Office, even though such balances may not have been formally consolidated. What has been regarded as foreign exchange held by the Riksbank then becomes, many months after the actual transactions occur, government credit to foreign countries. Such transfers are reported only in the yearbook of the Riksbank, and it is therefore impossible currently to identify the decline in the Riksbank's foreign exchange holdings as an extension of government credit. During 1946, the equivalent of about $20 million in pounds sterling and about $13 million in French francs were so transferred.

Difficulty is also caused by varying practices in valuing foreign exchange. During the period covered in the chart, the dollar values of a number of foreign currencies were altered, among them the French franc (December 1945), the Italian lira (January 1946), the Canadian dollar (July 1946), and the Turkish pound (September 1946). To the extent that these currencies were held by Sweden, one would expect the rate changes to be reflected in the total value of its foreign exchange holdings. It is impossible to identify such fluctuations, however, owing both to the lack of data concerning holdings of individual currencies and to the fact that foreign currencies have not always been booked at current values. The Riksbank states merely that prior to July 12, 1946, foreign exchange holdings were booked at rates below the market rates, and after that date have been generally booked at rates between the buying and selling rates. It is not certain that monthly fluctuations in market rates have always been taken into account in computing book values. Still less is known concerning the valuation practices of the commercial banks.

In the case of Denmark, the National Bank includes in its balance sheet as separate items accounts arising under payments agreements and clearing accounts. Until the end of December 1945, the latter included the Danish-German clearing account, which on that date was transferred to an account in the name of the Danish Government and ceased to be regarded as foreign exchange. In the chart, the amount of the German clearing debt--close to the equivalent of $590 million--has been deducted from the Bank's foreign exchange holdings also for the months June-November 1945. It is not certain, however, to what extent other inactive clearing accounts may be included; presumably all such accounts have been transferred to the Government, but dates and data are not available. Accounts arising under Denmark's post-war payments agreements with other countries--most notably the Danish-British account--are included in the National Bank's foreign exchange position as shown on the chart. Although the British have agreed to continue to hold the equivalent of $140 million in Danish kroner at least until the end of 1947, there has been no consolidation of the debt, and it is here regarded as a current foreign exchange liability. No information is available concerning the foreign exchange valuation practices of the National Bank or of the private banks in Denmark.

Some evidence of the growing inclination of both Swiss and Danes to hold their funds abroad may be found in comparison of their dollar assets as reported by banks in the United States with total foreign exchange assets as reported by their own banks. The dollar figures reported in this country include assets belonging to, for example, exporters and shipping firms as well as to banks; they therefore exceed the amount of dollar assets included in the totals reported by the banking systems in Sweden and Denmark. Comparison of the two sets of data is difficult because there are several variables which may explain divergencies in their development. When something is known about some of these variables, however, we may be able to draw conclusions about the others. The two chief variables are the amount of dollar receipts surrendered to the country's banking system, and the amount of foreign exchange other than dollars held by the banking system. Thus, on April 30, 1947, Sweden's short-term dollar assets in this country amounted to $157 million; total foreign exchange assets reported by the Swedish banks amounted to only $201 million. If it were assumed that most dollar exchange had been surrendered to the banks, then the difference between these two figures--or $44 million--would represent almost the whole of the Swedish banks' holdings of exchange other than dollars. This appears much too low, however, for a figure which would include, among other things, claims of the Riksbank arising under payments agreements. It is impossible to determine just how much of the $157 million represents dollars withheld from the Swedish banks, but large fluctuations in the amount of dollars withheld can be inferred from the data.

During the first seven months of 1946, Sweden's dollar assets in the United States declined only from $210 million to $204 million, but total foreign exchange gross assets reported by the Swedish banks increased from the equivalent of $272 million to $372 million. It is scarcely likely that during this period the banks' holdings of foreign exchange other than dollars increased so precipitously (even though total trade was increasing); rather is the explanation chiefly to be found in the accelerated tendency of exporters to deliver their dollar earnings to the Swedish banks during the period leading up to revaluation. During the nine months ending April 30, 1947, Sweden's dollar assets in the United States decreased by only $47 million, but total foreign exchange gross assets reported by the Swedish banks decreased by the equivalent of $171 million (despite increased exports), reflecting partly the reluctance of exporters to surrender dollar earnings after revaluation of the krona.

A similar tendency is noticeable with regard to Denmark. From April 1946 to the end of January 1947, total free foreign exchange gross assets reported by Danish banks (excluding assets on clearing and payments accounts, which eliminates many of the currencies other than dollars) declined from the equivalent of $89 million to $57 million, but Denmark's short-term dollar assets in the United States rose from $47 million to $73 million.

Heavy import surpluses[1] augmented by capital flight, have brought these two countries into fairly precarious positions. One remedy may be to tighten exchange controls and to requisition private exchange holdings. Sweden made preparations for this step last spring, when the Riksbank required that all holdings of certain hard currencies be reported as of May 15, 1947. This census disclosed the following short-term assets held on that date outside the banking system: $80 million in U.S. dollars, $32 million in pounds sterling, $5 million in Swiss francs, and $2 million in Portuguese escudos. From these figures it would appear that only about half of Sweden's short-term dollar assets ($157 million on April 30) had been delivered to the Swedish banks. Specific authority to requisition such private holdings was obtained from the Riksdag on June 30 of this year. Denmark, but not Sweden, already requires that current foreign exchange receipts be surrendered to the banking system; evasion of this rule, however, may be fairly widespread, particularly among shipping firms.

It appears unlikely, however, that requisitioning of private foreign exchange holdings would enable these countries to sustain their present balance of payments deficits for many months, and the decisive factor will be the degree of success they achieve in controlling the trade balance. The Swedish import restrictions imposed on March 15 should first begin to show effect in the trade returns for July and subsequent months. Danish exports are fairly certain to take a more favorable turn in the second half year. Unless these changes are marked, however, both countries may soon be faced with an urgent need for foreign credits.

1/ See this Review, June 17, 1947, p. 1.

PUBLIC FINANCE, MONEY MARKETS, AND INFLATION IN FRANCE

A. O. Hirschman

The French inflation, which had assumed a threatening pace in the second half of 1946, was suddenly brought to a halt by the announcement of the "Blum experiment" in December. With its threefold attack on prices, on private credit inflation,[1] and on the deficit of the public finances, it succeeded in radically altering the psychological climate and produced substantial lowering of prices in the stock, gold, and foreign bank note markets, as well as in the markets of commodities that are apt to be hoarded as a hedge against inflation. The general price level, though not too responsive to the two successive decrees ordering price reductions of 5 per cent each, remained stable up to April.

These gains, however, could not be maintained in the face of unfavorable developments in the "real" sector of the economy. In spite of increasing coal and power availabilities, industrial production remained stagnant in the first five months at a level of about 88 per cent of the 1938 average. More important, the food supply situation worsened as a bad wheat harvest became a virtual certainty. From April to May, wholesale and retail prices suddenly rose by 12 and 6 per cent, respectively, as a result of an even sharper rise in the prices of agricultural commodities. These

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1/ See this Review, January 28, 1947, p. 10.

rises have been responsible--jointly with the exit of the Communists from the Government--for the strike wave of the past two months. It seemed as though France had reached the threshold of yet another inflationary upsurge caused by successive price and wage increases as well as by the increased budget deficit.

It may be hoped that this danger has been averted by the Government's successful resistance to the wage demands of the unions, and by a series of energetic financial measures (cf. pp. 11-12). Wage increased remained on a moderate level. After a short strike, railway workers were granted pay increases and bonuses averaging 12 per cent, and in private industry the Government permitted collective bargaining for the negotiation of "production bonuses" up to 7 francs an hour equivalent to wage increases up to 15 per cent. The bonuses are supposed to be justified by the increase in production since the middle of 1946 and by the consequent reduction in overhead expenses and are not to form the basis for price increases. Similar upward adjustments for civil servants also have been granted. If compared to the wage and salary increases of July 1946 that averaged 33 per cent and reached 44 per cent in the case of the coal miners, the present pattern of increases cannot be considered as a major inflationary breakthrough.

The Financial Crisis of June

The increases granted were sufficient, however, to upset the balance of the ordinary budget that had been precariously achieved by Finance Ministers Philip and Schuman over the preceding months through a series of cuts in expenditures. This setback together with the outbreak of social disturbances had the effect of reversing the four-months-old trend on the stock and (black) foreign exchange markets, and the prospect of an increased level of costs enhanced the desire for liquidity on the part of banks and business and led to partial non-renewal of Treasury bond subscriptions. Complaints about insufficiency of liquid funds had already become increasingly vocal as a result of the price cuts and restrictive credit policy carried out during the previous months.

Any prospects of long-term borrowing were further dimmed by these developments. An issue of railway bonds of 10 billion francs was placed only with difficulty even before the present crisis. Subscriptions to 2.5 per cent, three-year Reconstruction bonds which are modeled on the U.S. War Bonds and were introduced in April, were unsatisfactory. Furthermore, the restrictive credit policy led to pressure on the market for government securities that could not be entirely met by the usual support from the Caisse des Depots et Consignations, the financial agency centralizing savings deposits.

This situation coincided with particularly heavy maturities of Treasury bonds in May and June amounting to 41 and 51 billion, respectively.1/ At the end of May the margin of available advances from the Bank of France to the Treasury, which had been increased by 40 billion in April through an accounting device,2/ amounted to only 36 billion francs.

1/ These bonds were issued at the time of the 1945 exchange of currency which had led to a large shift from currency holdings to bank deposits and to their investment in government bonds by the banks.

2/ By requiring the Bank to increase by 40 billion francs the permanent loan granted to the Government in countervalue of the right of note issue and by reducing the Treasury's advance account by the same amount.

Faced with renewed financial difficulties, the Government acted boldly. It may even be said that it "profited" from the threat of crisis in order to push through measures (such as the drastic reduction of subsidies and the renewal of the capital levy) which it would hardly have been able to enact in the normal course of affairs. Moreover, the Government chose wisely to have one big crisis rather than two separate ones, one now over the budget, the other somewhat later over the balance of payments. Although, because of the recently granted World Bank loan, there was no immediate necessity for further foreign financing, the Government in anticipation of larger needs in the fall asked and obtained from Parliament the transfer of $250 million[1/] worth of gold from the Bank of France to the Stabilization Fund. Should the gold transferred be actually sold, French gold holdings will be reduced to $445 million or to less than half of what was considered a safe minimum at the time of the Washington loan negotiations of 1946.

Successive 1947 Budget Estimates

In order to understand the financial measures that have been taken, the recent history of the French budget has to be briefly recalled. Both the Monnet Plan and M. Schuman's exhaustive "Financial Inventory" of December 1946 had preached the doctrine of equilibrium of the ordinary budget. Internal borrowing and extraordinary receipts--among which the most important were the countervalue in francs of foreign credits and of gold and foreign exchange liquidations--were to be reserved for the financing of the extraordinary or reconstruction budget which also included equipment outlay for nationalized enterprises and financial assistance to local governments.

Since preliminary estimates made early in 1947 showed a 110 billion deficit of the ordinary budget (550 billion receipts and 660 billion expenditures), reconstruction expenditures of 312 billion francs, and other outlays amounting to about 150 billion, it was decided to block 40 per cent of the reconstruction expenditures pending the balancing of the ordinary budget. It was indeed perfectly clear that the financing of this vast deficit expenditure of 572 billion could be achieved only by a massive injection of inflationary purchasing power.

In April, Schuman presented revised estimates in which the ordinary budget was shown in balance at a level of 590 billion francs, reconstruction expenditures at 187 (60 per cent of 312), and other outlays at 168 billion. Of the uncovered expenditure of 355 billion francs, 120 billion were expected to be realized through foreign exchange operations, and 80 billion through delay in cash expenditures by issuance of Credit National drafts to contractors and suppliers, leaving 155 billion to be raised by borrowing. At the time the contribution of genuine savings was expected to amount to 5 per cent of the estimated national income of 2,770 billion francs, or 135 billion. This rather bold assumption left only 20 billion expenditures to be accounted for.

Two months later, a new revision of the estimates was necessary. Expenditures had to be revised upward by 71 billion francs owing partly to the wage increases of railway workers and partly to some restoration of the

1/ Only 18 billion francs ($150 million) are to be transferred immediately, but authority is vested in the Government to transfer an additional 12 billion if necessary during the recess of Parliament.

earlier cuts in reconstruction expenditures. At the same time, the state of the money and capital markets led the Finance Minister to revise downward his estimate of the year's public borrowings by 45 billion francs to 90 billion. The prospect of increased imports, on the other hand, led to the expectation that franc receipts from foreign credits and gold liquidations would be higher by 10 billion francs than estimated. Total charges of the Treasury uncovered by either revenue or prospective borrowing amounted, therefore, to 126 billion francs.1/

New Financial Measures

The financial measures taken to cope with the situation were as follows:

(1) Subsidies on bread, milk, and the transportation and postal systems were cancelled leaving only the basic industrial raw materials of coal and steel in a subsidized status. On the other hand, in order to mitigate the effects of this momentous decision on the classes of the population that would be particularly hurt by the resulting price increases, family allowances as well as pensions for the sick and the aged were raised. The net savings realized will amount to 44 billion francs.

(2) New revenues will yield 75 billion francs. The most unexpected measure has been the increase by 25 per cent of the capital levy (solidarity tax) that had been instituted after the currency exchange of July 1945. The due date of the last quarter of the liability incurred under the tax was advanced from November to September and a "fifth quarter" is to become due in November. This measure aroused the opposition of the Right, but served to soften the Left's anger at the suppression of subsidies. Other revenue is to be obtained from increased excise taxes on tobacco, matches, alcohol, and gasoline; from increased application of the pay-as-you-go principle; from income assessments according to "outer signs of wealth";2/ and from sales of government-owned industrial shares and of surplus military vehicles.

(3) Finally, 30 billion billion francs are to be obtained from a further compression of civilian and, in particular, military expenditures.

Total resources thus obtained amount to 150 billion francs and exceed, therefore, the Treasury's expected deficit by 24 billion francs--a safety margin for the general salary increase for civil servants that was voted in just this amount on July 16. As was pointed out above, however, the Treasury's receipts still include net estimated internal borrowings of 90 billion, and it is by no means certain that even this reduced target can be reached. The Treasury itself was apparently anything but certain on that count since it asked Parliament also for an increase by 100 billion francs of its authority to borrow directly from the Bank of France. How necessary were these additional facilities is clear from the fact that advances in the amount

1/ 20 + 71 + 45 - 10 = 126.

2/ Widespread tax evasion by the "new rich" has made it necessary to resort to this time-honored expedient. Income presumptions are based on rent paid, the number of domestic personnel (a male servant leading to a presumption of twice that yielded by a female!), and on the horsepower of private cars owned.

of 44 billion francs were used during the month of June, exhausting entirely the previous authorization of 100 billion and using up 8 billion of the new one hardly a week after its passage through Parliament.

In spite of ever-recurring financial difficulties, the developments of the last months have yielded the following noteworthy results:

(1) Improved expenditure control and gradual inclusion of certain formerly extrabudgetary categories of public expenditure into the ordinary and extraordinary budget voted by Parliament.

(2) Progress of economic decontrol as evidenced by the suppression of most subsidies and by the abolition of tobacco and gasoline rationing. Excise taxes on these two products have been raised so as to bring their prices to a point where supply and demand are equated.

(3) Most important, achievement of the equilibrium of the ordinary budget owing to a sustained effort at reduction of expenditures and to raising of new revenues.

Private Vs. Public Credit Needs

The close interaction between private credit needs and the problems faced by the Treasury has recently been brought out very well in the first annual report of the National Credit Council, a supervisory and coordinating body that had been created by the Banking Law of December 2, 1945. The report provides breakdowns of bank credits by borrowers (business and government) and by lenders (Bank of France and commercial banks). The following table shows how, for 1946 (in particular for the second half of that year), the Bank of France financed a constantly increasing share of the total outstanding credits of the banking system while a constantly decreasing portion of these credits constituted a direct or indirect aid to the Treasury.

	Dec. 31, 1945		June 30, 1946		Dec. 31, 1946	
	Billions of francs	Per cent	Billions of francs	Per cent	Billions of francs	Per cent
Total Bank Credits - by lenders:						
Commercial Banks	340	87	421	84	474	79
Bank of France	52	13	80	16	126	21
Total	392	100	501	100	600	100
Total Bank Credits - by borrowers:						
Business	118	30	181	36	305	51
Government - total	(274)	(70)	(320)	(64)	(295)	(49)
Treasury bonds	243	62	260	52	210	35
Credit National drafts	31	8	60	12	85	14
Total	392	100	501	100	600	100

The credit expansion thus proceeded not by government borrowing from the commercial banks, but, on the contrary, through credits obtained by private industry and trade which were largely financed by the Central Bank, either directly through rediscounts or indirectly through non-renewals of Treasury bonds; the latter had to be refinanced in the form of direct advances from the Bank of France to the Treasury. The decrease of 50 billion Treasury bonds in the second half of 1946 is almost exactly matched by the increase in direct Bank of France advances to the Treasury (from 13 to 68 billion francs) during the same period. The increase in this item which is generally regarded by the French public as the most important indicator of the Treasury's position has, therefore, been caused less by the budget deficit than by the inability of the commercial banks to expand their lending to business enterprises without liquidating to some extent the credit previously granted to the Treasury. A similar situation has been responsible for the recent increase in direct Bank of France advances.

What little expansion of government borrowing from the banks there has been in 1946 has taken place through discounts of drafts in payment of contractors and suppliers. It has already been mentioned that these drafts, underwritten by the Credit National to make them eligible for rediscount at the Bank of France, are expected to be a major source of deficit financing during the current year. By a decree of February 27, 1946, the maturity of these drafts has been extended from 9 to 12 months and the settlement of public contracts through drafts (rather than cash) has been made compulsory for the full amount of the sums due rather than, as previously, for 75 per cent only.1/

Capital Markets and Private Savings

Average levels of real income being quite low, savings out of current income are quite small under present conditions. In addition, as is to be expected in a period of inflationary pressures, great difficulties are experienced in channeling what private savings there are toward the investments planned by the State. Furthermore, the nationalization of important branches of French industry had the consequences that these branches could finance themselves only through fixed-income issues which were at a clear disadvantage with respect to variable-income securities because of the constant rise in prices.

In 1946, new bonds and shares were issued in the amount of 84 billion francs, half of which were bond issues of the semi-public Credit National and Credit Foncier; nationalized enterprises accounted for 9 billion francs; the surprisingly large amount of 22 billion went to private consumers' goods industries.2/

1/ Of a total of 98 billion Credit National drafts in circulation on December 31, 1946, 86 billion were held in the banking system and were distributed in approximately equal amounts between the commercial banks (44 billion) and the Bank of France (42 billion). Even if 100 per cent of the drafts were to be rediscounted, the Treasury would still obtain the advantage of having avoided to that extent an increase of its direct advances from the Bank of France with its attendant "psychological" consequences.

2/ Etudes et Conjoncture, March-April 1947, p. 12.

Available resources of the Caisse des De ts et Consignations, the agency centralizing the funds of savings banks and social security contributions and using them for underwriting government securities, increased by 64 billion francs, but of these 45 billion had to be used to support the market of government securities rather than for new subscriptions.

The Report of the National Credit Council presents an estimate of private capital formation by adding the 19 billion franc net increase in resources of the Caisse des Depots to the 84 billion new market issues. There is, however, some double counting between these two items since part of the increase in funds at the disposal of the Caisse doubtless went to subscribe to bond issues of such quasi-public bodies as the Credit National and the Credit Foncier. It appears likely, therefore, that private savings excluding changes in cash holdings have remained below 100 billion francs; they have amounted, therefore, to about 3 per cent of the national income of 2,770 billion francs. This result makes it quite improbable that it will be possible to reach in 1947 the Monnet Plan target of 9 per cent[1/] of which the Government had expected at one point to obtain about one-half.

Future of the Monnet Plan and Inflation

It seems clear, therefore, that, with present low levels of real income, private capital formation is incapable of contributing to the financing of the planned investment expenditure to the extent envisaged by the Monnet Plan. Realization of this fact has brought about three distinct developments:

(1) Objectives of the Plan are being scaled down, although no official indication of this has as yet been given except for the reduction of extraordinary government expenditures.

(2) Recent financial measures have, for the first time, brought forth the tendency to raise investment funds through taxation, i.e., by securing a surplus in the ordinary budget.[2/] The proceeds from the 25 per cent increase in the solidarity tax and from certain other taxes have been specifically set aside for the financing of the extraordinary budget.

(3) Residual reconstruction expenditure, i.e., that part that is not covered by tax or extraordinary non-tax receipts (such as franc proceeds from foreign loans and gold sales), is financed primarily by the banking system. This residual is the result of a constantly shifting compromise between the minimum requirements of the investment program and the maximum limits assigned to inflationary means of finance by an uneasy and experimental concept of "controlled inflation".

1/ Total investment envisaged by the Monnet Plan for 1947 is estimated at 17 per cent of national income to be raised in the following manner: 5 per cent through the franc proceeds of foreign loans and gold liquidations, 3 per cent through self-financing of business and farm enterprises, and 9 per cent through the capital market.

2/ All taxation, ordinary and extraordinary, has so far been included in the ordinary budget.

This threefold attack--slowing down of the investment program, financing of investment from a surplus in the ordinary budget, and a limited amount of inflationary finance--could provide the pattern for meeting the difficulties of the active reconstruction period provided a solution is found for two problems:

(1) Agricultural output. It was seen earlier that the latest inflationary spurt was due almost exclusively to a rise in farm prices reflecting unsatisfactory output and distribution of farm products. Increasing agricultural output is a preliminary condition if controlled inflation is not to degenerate into runaway inflation through constant increases of food prices and the consequent irrepressible demands for higher wages.

(2) Exchange rate. With internal prices and costs under slow but steady pressure, the present exchange rate already has become a barrier to French exports in several lines, including tourism. If it is correct, as is argued in the foregoing, that continuation of inflationary pressures is to be reckoned with for some time, the question of an adjustment in the rate is certain to become acute.

RUSSIAN INDUSTRY IN THE SECOND QUARTER OF 1947

A. G.

The report of the Gosplan on the economic results achieved during April-June 1947[1] follows, with a few exceptions, the pattern of previous reports for 1946 and the first quarter of 1947.[2] This means that most of the data refer to industrial developments, the information being divided into two parts: (1) percentage data on the degree of fulfillment of the quarterly plan by the individual industrial Ministries, and (2) percentage increases in output of important commodities over the second quarter of the last year.

The average degree of fulfillment of the plan by all Ministries combined is divulged for the first time, the figure being 103 per cent. Although no such figure is given for the earlier period, the degree of plan fulfillment in the most recent period appears to be much higher than was the case in the first quarter of 1947. While in that period few of the Ministries reported overfulfillment, and the majority showed considerable lags, the more recent quarter ended with five-sixths of the Ministries having exceeded the plan targets, while the lags of the remaining Ministries were quite small. Thus, the Ministry responsible for output of agricultural machinery, which in 1946 had remained 23 per cent behind the target, fulfilled 99.7 per cent of the quarterly plan. On the other hand, the overfulfillment of the plan for ferrous metals by 3 per cent may cause surprise in view of repeated vigorous charges in the press according to which the rate of output of the responsible Ministry was too low.

The list of individual commodities for which data are given includes 48 items as against 37 in the preceding report. Appraisal of the significance of the percentage-wise increases is difficult, because they

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1/ Cf. Pravda, July 8, 1947.
2/ See this Review, March 25, 1947, and May 6, 1947.

relate to the unknown situation in the second quarter of 1946. Nevertheless, a few comparisons may be hazarded with regard to output of some basic industrial materials. The following table shows the scheduled increases for the whole year 1947 over 1946 and the quarterly increases in 1947 over the corresponding periods of the preceding year.

Increases in Output

	1947 as percentage of 1946	2nd quarter 1947 as percentage of 2nd quarter 1946	1st quarter 1947 as percentage of 1st quarter 1946
Pig iron	121	112	110
Steel	119	108	a/
Coal	116	111	104
Oil	118	118	115

a/ Cf. footnote (a), table below.

The relative increases in the second quarter were considerably higher than those in the first quarter of the year. This is true not only of the materials just listed, but of a good many other commodities, with the exception of those the output of which had dropped to very low levels in the course of the war. Looking back over the Russian press reports in 1946 when no Gosplan reports were yet published, one does not gain the impression that the output in the second quarter of 1946 proceeded at a rate lower than that of the first quarter. Thus, genuine progress seems to have been achieved. On the other hand, the rates of growth for the commodities listed, except for oil, in the second quarter of this year are still very much below the rate called for by the plan for the whole year 1947; in the first quarter, output of none of the four commodities attained the rates of the annual plan. The burden thus placed on the remaining quarters of the year may be roughly shown on the basis of our previous estimates if we assume that the 1945-46 rate of growth applied uniformly to the individual quarters of 1946.1/

Output in Millions of Metric Tons

	1st quarter, 1947	2nd quarter, 1947	Target for 1947	Remains to be produced during remainder of 1947
Pig iron	2.6	2.7	12.1	6.8
Steel	3.7a/	4.1	18.2	10.8
Coal	43.0	48.0	204.4	113.0
Oil	5.50	6.3	25.6	13.8

a/ Since no figure for the first quarter of 1947 was given, it must be assumed that no increase as against the first quarter of 1946 was achieved. Accordingly, the estimated output of the first quarter of 1946 is used in the table, although output may in fact have been lower in the first three months of 1947 than a year earlier.

1/ See this Review, March 25, 1947.

In other words, in order to attain the 1947 target, output in the second half of 1947 would have to grow over that of the first half of the year by the following percentages:

Pig iron	28
Steel	33
Coal	19
Oil	17

Much is being said at present in the Russian press about advancing the 1947 goals from the end of the year to the 30th anniversary of the October Revolution (November 7), thus shortening the plan period by some 15 per cent. But even if no such abridgment should take place, it is quite improbable that an increase in output of such formidable dimensions can be achieved. In fact, an underfulfillment of the annual plan seems inevitable. This lag may be less significant in the case of coal and oil, because output of these products in 1946 was close to the plan and a target was set for 1947 which, if achieved, would imply considerably faster progress than is called for by the schedules of the Five Year Plan. It is different in the case of ferrous metals, where the 1946 performance was poor and the high 1947 targets were designed to raise output to a level consonant with the goals of the Five Year Plan. There is no doubt that the slow growth of steel output is one of the most important retarding factors in the Russian economic development.

The most significant innovation of the present report lies in the fact that for the first time the percentage increase in the volume of <u>total</u> industrial production is given. The previous reports recorded the relative increases in the output of <u>civilian</u> goods only. It has been variously estimated that the total industrial output in 1946 was about 5 per cent lower than in 1945, because military output decreased more than civilian output increased. The present report states that total industrial output in the second quarter of 1947 was 15 per cent higher than that of the second quarter in 1946. One probably would not go far wrong in assuming that the present level of output is approximately 10 per cent higher than that of 1945, or very close to that of 1940. The average annual rate of industrial growth foreseen by the Five Year Plan is 10 per cent. Thus the present output probably has not yet compensated for the deficiencies of 1946. This in itself does not mean that the Five Year Plan will be underfulfilled. But it is safe to believe that its objective in the industrial field will not be attained unless either production of steel is greatly stepped up or else much greater recourse to imports of steel and machinery will take place than has been the case so far.